

## #40 CONTRACTORS

### An Educational Guide to Sales Tax in the State of Idaho

This brochure is intended to help contractors understand the sales tax laws that apply to their business. This information is based on the sales tax laws and rules in effect on September 1, 2006.

#### Who is a contractor?

A contractor is anyone who builds, improves, repairs, or alters *real property*, either commercial or residential. Contractors include prime contractors, general contractors, subcontractors, and “speculation” contractors. Speculation contractors build on property they own in anticipation of selling it later.

*Examples of contractors include:*

bricklayers	fence builders
electricians	carpet layers
land levelers	plumbers
mechanical contractors	roofers
window installers	landscapers
drywall installers	pump installers
garage door installers	painters
sheet metal contractors	well drillers
heating and air conditioning installers	

#### What if I only do residential repairs?

You’re considered a contractor by Idaho law. The information in this brochure applies to you.

#### What is real property?

“Real property” refers to land and improvements or fixtures to the land.

Improvements or fixtures include things that are physically attached to the land or to other improvements. *For example*, a house and fence are both improvements to the land on which they’re built. Improvements and fixtures also include things attached in such a way that they’d be sold along with the land. *For example*, you’d expect to leave the light fixtures in a home you sold because they’re attached to the property.

## What's the difference between a contractor, a retailer, and a contractor/retailer?

A **contractor** installs or attaches materials to real property. A **retailer** sells goods, but doesn't attach them to the real property. A **contractor/retailer** does both.

## How does sales tax apply to a contractor?

The sales tax law says a contractor is the consumer of the goods he uses. Therefore, he must pay sales tax on all his purchases.

Contractors owe sales tax when they buy equipment, tools, and supplies used in their business. They must also pay sales tax when they buy building materials and fixtures. "Fixtures" include lighting or plumbing fixtures, furnaces, boilers, heating or air-conditioning units, refrigeration units, elevators, hoists, awnings, vaults, cabinets, counters, carpet, garage doors, water heaters, etc.

If a contractor makes purchases and isn't charged sales tax, he must pay use tax. The contractor must get a use tax number from the Idaho State Tax Commission and file use tax returns. The use tax rate is the same as the sales tax rate.

## What if the customer is exempt from sales tax?

Even if the customer is exempt from paying sales tax, as in the case of a government agency, the contractor must still pay tax on his purchases.

## What if the customer has direct pay authority?

Some project owners may be granted direct pay authority by the Tax Commission. This means they buy tangible personal property exempt from tax and, if tax is due, pay it directly to the state instead of the supplier.

A contractor may not make exempt purchases using the customer's direct pay authorization. This authority can't be transferred.

A contractor must also pay tax on the materials he installs into real property even when project owners give him a copy of their direct pay authorization.

## What if the customer provides the job materials?

If a project owner buys materials for a job and pays sales or use tax, the contractor who installs these materials doesn't owe any additional tax. However, if the owner hasn't paid tax on the materials he gives to the contractor, the contractor must pay use tax on the value of those materials. This occurs most often when the contractor does work for a project owner who is exempt from paying tax, as in the case of a nonprofit hospital, school, or government agency.

## If a contractor fabricates material for a job, how much tax applies?

If a contractor fabricates his job materials, the amount of use tax he owes is based on the value of the material at the time he first handles it for a specific project to improve real property. *For example*, if a contractor buys steel for a specific job and fabricates it for use on that job, he owes use tax only on the materials he has purchased.

However, if the contractor fabricates steel and puts it into a resale inventory for future use, he owes tax on the full value of the fabricated steel when he incorporates it into real property. That value is called the “fabricated value” and includes the cost of the materials plus the fabrication labor.

## Should a contractor charge sales tax on the materials he installs?

No. A contractor doesn’t charge his customers sales tax. His bid should be high enough to cover any taxes he’s had to pay on materials without itemizing sales tax on his bid. If he does charge sales tax, his customer can refuse to pay it.

*Example:* A cabinetmaker agrees to build cabinets and install them in a home. He bids the job for labor and materials. The materials cost him \$1,000. If the tax rate is 6%, he must pay \$60 sales tax to his material supplier or, if the supplier doesn’t collect Idaho sales tax, he must pay \$60 use tax to the state. When he bills his customer, he has a materials cost of \$1,060. He reimburses himself for his material costs (including the tax he paid), but he *doesn’t* charge his customer sales tax.

The bill might read:

Job materials	\$1,060
Labor	\$3,000

## How does sales tax apply to a retailer?

A retailer must get a seller’s permit to collect and pay sales tax. A cabinetmaker who builds cabinets and delivers them to another contractor to install in a home is a retailer. As a retailer, the cabinetmaker must collect sales tax on the full retail sales price of the cabinets, including the labor to make them.

His bill might read:

Materials to build cabinets	\$1,000
Labor to build cabinets	\$2,500
Sales tax on \$3,500	\$ 210*

(\*If the tax rate is 6%)

## How does sales tax apply to a contractor/retailer?

Many contractors are also retailers. Plumbers, electricians, carpetlayers, cabinetmakers, and mechanical contractors, to name a few, are usually both contractors and retailers. They are contractors when they install materials in the course of a residential or commercial service call or contract; but when they sell items or materials they don’t install, they are retailers and need to collect sales tax from their customers.

If you're a contractor/retailer, you must ensure that the correct tax is paid. Since part of your materials will be subject to tax on cost (when you act as a contractor), and part will be subject to the collection of sales tax (when you act as a retailer), you must keep records that allow you to properly account for the tax.

You may follow any consistent procedure that properly accounts for the tax due. *For example*, if the majority of your business is in retailing, you may want to buy all your materials without tax by giving your supplier a completed form ST-101, Sales Tax Resale or Exemption Certificate. For more information on exempt sales, see Brochure #5 - Retailers and Wholesalers: Making Exempt Sales. When you retail the goods, you will collect sales tax. If you install the materials into real property, you will owe use tax on the cost of the goods.

## Are there other ways I can account for the tax?

If the majority of your business involves contracting, you may want to pay tax on all materials as you buy them. Then, if you install the goods into real property, you've paid the sales tax and no use tax is due. If you sell goods at retail and collect sales tax from the customer, you can take an adjustment on your sales tax return to subtract the tax you paid the vendor on the items you resold from the tax you owe the state. You must attach documents or a letter of explanation to support your adjustment when filing your return.

Another commonly-used method of recordkeeping is maintaining a resale inventory purchased without paying sales tax. Then you pay use tax when materials are taken from inventory, and you pay sales tax when buying materials for major contracting jobs.

## How should I handle a contract where I'm both a contractor and a retailer?

When you're bidding a job with mixed contract services and retail goods, be sure to separate these on your invoice to the customer, and be sure to charge tax on the retail portion.

*For example:* Let's say you're a cabinetmaker who contracts to build kitchen cabinets and a freestanding china hutch for a homeowner. If you install the kitchen cabinets, you're acting as a contractor and owe tax on your material costs. But since the hutch is freestanding (not installed into real property), you're acting as a retailer and must collect tax from the homeowner on the retail sales price of the hutch (including your labor to build it).

Your bill might read:

Furnish and install kitchen cabinets		\$5,000
Build freestanding hutch	\$1,000	
Sales tax on hutch	\$ 60*	
(*If the tax rate is 6%)		
		<u>\$1,060</u>
Total		\$6,060

## Do contractors qualify for any exemptions?

A special exemption applies to contractors working in states with no sales tax (e.g. Montana, Oregon, and Alaska). Nonspeculation jobs in Washington also qualify for this exemption if the project owner isn't the federal government. (In a nonspeculation job, the contractor doesn't own the real property.) A contractor doesn't have to pay tax on materials delivered to him in Idaho *as long as* those materials will be incorporated into real property on his job in a state with no sales tax. To claim the exemption, the contractor must complete form ST-101 and give it to the vendor.

Contractors who fabricate production machinery for a manufacturer may make tax-free purchases of the materials that become part of the production equipment. They must give the vendor a completed form ST-101 for his records.

Contractors who install equipment used in agricultural irrigation, such as pumps and pipes, can buy these materials tax exempt. They must give the vendor a completed form ST-101.

A contractor who is an enrolled member of an Indian tribe with a job on the reservation may take delivery of materials on the reservation without owing sales or use tax. However, tax applies if the materials are delivered to an American Indian contractor off the reservation. A non-Indian contractor improving real property on an Indian reservation usually is subject to sales and use tax.

## Am I responsible for my subcontractor's sales or use taxes?

No. If you hire a subcontractor to furnish and install materials, he is responsible for the tax on the materials he buys.

However, if you buy the materials and hire a subcontractor to install them, you must pay the tax on the materials. If you don't, either you or the subcontractor can be held liable for the tax.

## Does a contractor have to pay tax when he applies rock?

A contractor who applies crushed rock is improving real property. If the contractor buys the crushed rock, he must pay tax on the purchase price. If the crushed rock is provided by the project owner or government agency that hasn't paid tax on the rock or the crushing services, the contractor owes tax on the value of the rock. The value is the "crushed value" (what a buyer would pay to a gravel pit owner for this type of crushed rock). If the contractor who applies the rock also crushed it, the value of the rock is the raw material cost (generally the royalty fee).

## Does a contractor have to pay tax when he crushes and stockpiles rock?

When a rock crusher contracts to crush and stockpile rock owned by another, he is not a contractor improving real property. Instead, he is a retailer of taxable processing services.

The rock crusher must get a seller's permit number and charge sales tax on his retail sale of crushing services (including mobilization fees). If his customer is exempt from paying sales tax, as in the case of a state or federal government agency, no tax applies.

## What if the buyer of crushing services will resell the crushed rock?

If the rock crusher is crushing and stockpiling rock for a customer who will resell it, the services aren't taxable if the buyer provides a completed resale certificate (form ST-101).

The rock crusher may qualify for the production exemption on his equipment, fuel, and certain supplies if the majority of his business is crushing rock that will be resold. This is true even if the crusher isn't the owner of the rock. For more information on the production exemption and mining, see Brochures #30 – The Production Exemption and #34 – Mining.

## Are subcontractors who work at the INL exempt from sales tax?

No. Subcontractors who improve real property at the Idaho National Laboratory must pay tax on purchases for these projects, just as they would for other real property improvements.

### For more information, read:

Brochure #2	Use Tax
Brochure #5	Retailers and Wholesalers: Making Exempt Sales
Brochure #30	The Production Exemption
Rules 12, 13, 14, and 15	The Contractor Rules
Rule 16	Retail Sale of Asphalt, Concrete, and Concrete Products

#### For more information, contact:

- Idaho State Tax Commission: In the Boise area, 334-7660; Toll free, (800) 972-7660
- Hearing impaired: TDD (800) 377-3529
- **tax.idaho.gov**

This information was prepared by the Idaho State Tax Commission. It does not provide comprehensive explanations of Idaho tax laws or rules. Specific questions should be addressed to the Tax Commission or a qualified tax practitioner.